

**Testimony to Senate Taxation Committee on SB 273**  
**Adopt a Five Year Statute of Limitations for Corporations**

**Dan Bucks, Director of Revenue**

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Mr. Chairman and Members of the Senate Taxation Committee, my name is Dan Bucks, and I serve as Montana's Director of Revenue. I am here to recommend passage of SB 273 introduced by Sen. Williams at the request of the Governor. This bill is included in the Governor's budget recommendations. I want to thank Sen. Williams for sponsoring this important bill that will improve tax fairness and simplify the tax system—and that will ultimately benefit Montana businesses and help them create higher paying jobs.

In the tax laws, the statute of limitations fixes the normal period for which a taxing authority can audit a taxpayer who has filed a return and, if it is an even-handed statute, for which a taxpayer can amend a return to file for a refund.

For decades, the corporate tax statute of limitations in Montana was five years. At some point in the 1990s, it was shortened to three years—even though the statute of limitations remained at five years for individual income tax purposes including the individuals who own businesses operating as a sole proprietorship, S-corporation, partnership or limited liability company.

So corporations subject to the corporation tax—generally referred to as C-corporations—have an unjustified advantage over individuals and small businesses when it comes to audits. This advantage is doubly unjustified given that multistate and multinational corporations have much more complex returns and books and records to audit than individuals and small businesses do, engage in considerably more aggressive income shifting and tax planning strategies, and based on our audits typically underreport income by 25% or more. Three years is simply not enough time for the state to do a sufficient number of audits of large, out-of-state corporations to ensure that such corporations are fully and properly reporting the income they earn in Montana. Restoring Montana's statute of limitations to five years is only fair to all taxpayers in Montana, and it is simpler for everyone—taxpayers and tax practitioners—to understand if the state has only one statute of limitations for income taxes instead of two.

It is important to note that SB 273 restores the statute of limitations to five years in an even-handed manner. Although the state will have an opportunity to audit a corporation in a five year period, the corporation will have an equal, five year opportunity to request a refund if they find an error they made in their original tax return.

How does SB 273 compare with the federal government and the majority of states? The answer is that in the context of corporate taxation, the federal government and over half the states actually have a six-year statute of limitations. (See first attachment.) Their statutes of limitations start at three years, but the IRS and the majority of state revenue agencies can extend the audit period to six years if they find underreporting above a certain threshold which in audits of large corporations is easily achieved. Not only is this de facto six-year statute of limitation practice longer than the five years in SB 273, the federal

government and the other states are not even handed in their practice—because only the tax agencies can extend the statute. Taxpayers cannot, at their choice, extend their refund period from three to six years. SB 273, in contrast, is more equitable and even handed because tax authorities and taxpayers have an equal opportunity to use the time period to achieve what they believe is a proper and accurate tax result. The five year statute is also simpler in several audit contexts and is not subject to auditor discretion as to whether a statute should be extended to six years as in the case of the practice of the federal government and the majority of other states.

There is another dimension of fairness and simplicity that is achieved through SB 273 in the context of the owners of pass-through entities that are partnerships or limited liability companies. (See second attachment.) Typically the owners of these entities, and not the entities themselves, are responsible for paying the taxes on income earned by these enterprises. If the owner of a limited liability company or partnership is an individual, that person will be subject to audit and assessments for five years. However, the corporation that owns a share of this business will be subject to audit and assessments for only three. Conversely, if the business owners discover that they overpaid in the fourth or fifth year after filing a return, the individual owner can claim a refund, but the corporate owner cannot. This circumstance is not only obviously unfair; it adds substantial, unnecessary complexity to the tax process for both the Department and the taxpayers. SB 273 will improve tax fairness by ending the disparate treatment of individuals as compared to corporate owners of pass-through entities and it will simplify the tax process in these cases.

What is the impact of SB 273 on small businesses? This bill will have a positive effect on small businesses by protecting them from paying taxes that ought to be paid by large, out-of-state corporations and preventing unfair competition from those same corporations. There are over 40,000 businesses in Montana organized as pass-through entities—and increasingly small business owners choose that structure over creating a C-corporation. This bill does not affect pass-through entities in any direct legal sense at all because those businesses and the individuals who own them are already subject to a five-year statute of limitations under the individual income tax. Keep in mind that this is a growing share of small businesses in Montana.

Even though the C-corporation structure is a declining share of Montana small businesses, how does this bill affect them? The answer, in practical tax audit terms, is not at all. Why, because it makes no sense for the State of Montana, given scarce audit resources, to increase audits of small Montana corporations. The bulk of the corporation tax is paid by a relatively few large corporations. For tax year 2007, 500 corporations paid 93% of Montana's corporation tax. These corporations—often Fortune 500 to Fortune 1000 companies—not only represent the lion's share of the Montana corporate tax base, but they also represent the greatest tax reporting problems. Again, our out-of-state corporate audits typically find income underreporting in amounts exceeding 25%. Further, much of this underreporting represents the same issues for which we have audited these corporations before and which they have chosen not to correct.

So this bill is really all about audits of large out-of-state companies—because that is where the largest income reporting problems occur and where the State of Montana achieves the better rate of return on its limited audit resources. There is no reason for Montana to increase what are primarily office and

correspondence audits of small Montana corporations, because that is not where the bulk of underreporting occurs or where the best audit rate of return can be achieved.

This bill is also an efficiency measure. With no increase in staff, the state will be able to increase its audit return as reflected in the fiscal note by conducting more effective audits of large out-of-state corporations that are responsible for the major share of Montana corporation taxes.

The net effect of SB 273 on Montana businesses is to bring them the benefits of greater tax fairness—keeping taxes lower for Montana businesses, protecting them from having to pay taxes that should be paid by large, out-of-state corporations and defending them from unfair competition from those same corporations. In this way SB 273 will ultimately help Montana businesses succeed and enable them to create higher paying jobs for Montanans.

I urge your approval of SB 273.

(Attachment I)

## Corporate Tax Statute of Limitations

Statute of Limitations	Number of States
4 year statute of limitations with an extension of at least to 6 years if income is understated by 25%	6
3.5 year statute of limitations with an extension to 6.5 years if income is understated by 25%	1
Federal - 3 year statute of limitations with an extension to 6 years if income is understated by 25%	Federal
3 year statute of limitations with an extension to 6 years if income is understated by 20% to 25%	18
3 year statute of limitations with an extension to 6 years if income is understated by 50%	1
3 year statute of limitations with an extension to 5 years if income is understated by 25%	1
SB273 Proposal - 5 year statute of limitations same as for Montana individual income tax	-
4 year statute of limitations	2
3 year statute of limitations	18
No Corporate Tax	4

